

# Risk Management and Employee Benefits Trust Report on Audit of Financial Statements

Fiscal Year Ended June 30, 2004



Maricopa County, Arizona

[www.maricopa.gov](http://www.maricopa.gov)

**MARICOPA COUNTY**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Report on Audit of Financial Statements**  
June 30, 2004

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**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Report on Audit of Financial Statements**  
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**DEBRA K. DAVENPORT, CPA**  
AUDITOR GENERAL

**STATE OF ARIZONA**  
**OFFICE OF THE**  
**AUDITOR GENERAL**

**WILLIAM THOMSON**  
DEPUTY AUDITOR GENERAL

**Independent Auditors' Report**

Members of the Arizona State Legislature

The Board of Supervisors of  
Maricopa County, Arizona

We have audited the accompanying financial statements of the Maricopa County Risk Management and Employee Benefits Trust Funds as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the County's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the Trust Funds' financial statements are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the governmental activities and aggregate remaining fund information of Maricopa County that is attributable to the Trust Funds. They do not purport to, and do not, present fairly the financial position of Maricopa County as of June 30, 2004, and the changes in its financial position and its cash flows, for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Maricopa County Risk Management and Employee Benefits Trust Funds as of June 30, 2004, and the changes in its financial position and its cash flows, for the year then ended in conformity with U.S. generally accepted accounting principles.

Debbie Davenport  
Auditor General

December 21, 2004

**MARICOPA COUNTY**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Statements of Net Assets—Internal Service Funds**  
**June 30, 2004**

	<u><b>Risk Management</b></u>	<u><b>Employee Benefits</b></u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents-		
Risk management	\$ 30,766,039	
Environmental insurance claims recovery	1,456,569	
Employee benefits		\$ 11,040,473
Interest receivable	133,509	42,879
Accounts receivable	219	1,782,172
Prepaid insurance	1,705,787	1,138,598
Total current assets	<u>34,062,123</u>	<u>14,004,122</u>
Noncurrent assets:		
Machinery and equipment	51,676	
Less: accumulated depreciation	<u>(49,286)</u>	
Total noncurrent assets	<u>2,390</u>	
<b>Total assets</b>	<u>34,064,513</u>	<u>14,004,122</u>
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	850,963	1,868,796
Employee compensation payable	105,387	
RBUC and IBNR claims	<u>15,813,549</u>	<u>5,139,150</u>
Total current liabilities	<u>16,769,899</u>	<u>7,007,946</u>
Noncurrent liabilities:		
RBUC and IBNR claims	<u>26,719,064</u>	
Total noncurrent liabilities	<u>26,719,064</u>	
<b>Total liabilities</b>	<u>43,488,963</u>	<u>7,007,946</u>
<b>Net Assets</b>		
Invested in capital assets	2,390	
Unrestricted (deficit)	<u>(9,426,840)</u>	<u>6,996,176</u>
<b>Total net assets (deficit)</b>	<u>\$ (9,424,450)</u>	<u>\$ 6,996,176</u>

See accompanying notes to financial statements.

**MARICOPA COUNTY**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Statements of Revenues, Expenses, and**  
**Changes in Fund Net Assets—Internal Service Funds**  
**Year Ended June 30, 2004**

	<b>Risk Management</b>	<b>Employee Benefits</b>
<b>Operating revenues:</b>		
Charges for services	\$ 25,676,986	
County and employee premiums		\$ 27,616,161
Other income	131,731	199,068
<b>Total operating revenues</b>	<b>25,808,717</b>	<b>27,815,229</b>
<b>Operating expenses:</b>		
Personal services	1,209,017	
Supplies and services	522,338	
Accounting and auditing fees	12,173	
Actuary fees	36,500	
Consulting and management fees	198,048	
Brokers' fees	130,000	
Claims administration service fees	398,395	1,409,157
Legal expenses	6,702,686	
Claims and insurance:		
Auto liability claims paid	305,267	
Auto liability RBUC and IBNR claims decrease in estimate	(21,084)	
Total auto liability	<u>284,183</u>	
General liability claims paid	1,420,281	
General liability RBUC and IBNR claims increase in estimate	1,820,117	
Total general liability	<u>3,240,398</u>	
Workers' compensation claims paid	4,570,705	
Workers' compensation RBUC and IBNR claims decrease in estimate	(575,884)	
Total workers' compensation	<u>3,994,821</u>	
Medical malpractice claims paid	482,400	
Medical malpractice RBUC and IBNR claims increase in estimate	184,362	
Total medical malpractice	<u>666,762</u>	
Auto physical damage claims paid	357,352	
Auto physical damage RBUC claims increase in estimate	21,004	
Total auto physical damage	<u>378,356</u>	
Property claims paid	371,781	
Property RBUC claims increase in estimate	56,327	
Total property	<u>428,108</u>	
Pharmacy claims paid		11,025,730
Pharmacy IBNR claims decrease in estimate		(512,777)
Total pharmacy		<u>10,512,953</u>
Medical claims paid		3,724,882
Medical RBUC and IBNR claims increase in estimate		3,568,000
Total medical		<u>7,292,882</u>
Dental claims paid		4,801,989
Dental IBNR claims increase in estimate		55,572
Total dental		<u>4,857,561</u>

See accompanying notes to financial statements.

(Continued)

**MARICOPA COUNTY**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Statements of Revenues, Expenses, and**  
**Changes in Fund Net Assets—Internal Service Funds**  
**Year Ended June 30, 2004**  
**(Continued)**

	<u><b>Risk Management</b></u>	<u><b>Employee Benefits</b></u>
Short-term disability claims paid		\$ 1,826,457
Short-term disability IBNR claims decrease in estimate		(253,518)
Total short-term disability		<u>1,572,939</u>
Hospital co-pay reimbursements claims paid		18,285
Medical incentives paid		751,218
Wellness incentives paid		5,843
Insurance claims paid		2,337
General medical IBNR claims decrease in estimate		(165,031)
Total general medical		<u>612,652</u>
Unemployment claims	\$ 801,973	
General liability insurance premiums	1,673,262	392
Workers' compensation insurance premiums	487,710	
Crime insurance premiums	35,419	
Property insurance premiums	594,760	
Malpractice insurance premiums	1,139,894	
Stop loss insurance premiums		75,739
Depreciation	9,510	
<b>Total operating expenses</b>	<u>22,944,313</u>	<u>26,334,275</u>
<b>Operating income</b>	2,864,404	1,480,954
<b>Nonoperating revenues:</b>		
Investment income	275,669	186,986
<b>Total nonoperating revenues</b>	<u>275,669</u>	<u>186,986</u>
<b>Income before transfers</b>	3,140,073	1,667,940
Transfers from other County funds		2,374,000
<b>Increase in net assets</b>	3,140,073	4,041,940
<b>Total net assets (deficit), July 1, 2003</b>	<u>(12,564,523)</u>	<u>2,954,236</u>
<b>Total net assets (deficit), June 30, 2004</b>	<u><u>\$ (9,424,450)</u></u>	<u><u>\$ 6,996,176</u></u>

See accompanying notes to financial statements.

**MARICOPA COUNTY**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Statements of Cash Flows—Internal Service Funds**  
**Year Ended June 30, 2004**

	<b>Risk Management</b>	<b>Employee Benefits</b>
<b>Cash flows from operating activities:</b>		
Receipts from other funds	\$25,808,717	\$26,271,156
Other receipts		199,068
Payments for fees, supplies, and services	(7,863,133)	(1,409,157)
Payments for insurance claims	(8,309,759)	(21,637,155)
Payments for insurance premiums	(3,998,768)	(1,100,248)
Payments to employees	(1,193,859)	
Net cash provided by operating activities	<u>4,443,198</u>	<u>2,323,664</u>
<b>Cash flows from noncapital financing activities:</b>		
Cash transfers from other funds		<u>2,374,000</u>
<b>Cash flows from investing activities:</b>		
Interest received on investments	<u>216,656</u>	<u>167,744</u>
Net increase in cash and cash equivalents	4,659,854	4,865,408
Cash and cash equivalents, July 1, 2003	<u>27,562,754</u>	<u>6,175,065</u>
Cash and cash equivalents, June 30, 2004	<u><u>\$32,222,608</u></u>	<u><u>\$11,040,473</u></u>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	\$ 2,864,404	\$ 1,480,954
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	9,510	
Net change in RBUC and IBNR claims, noncurrent portion	44,024	
Changes in assets and liabilities:		
Increase in:		
Accounts receivable	(219)	(1,013,321)
Prepaid insurance	(67,723)	(1,024,117)
Accounts payable	137,226	519,586
Employee compensation payable	15,158	
RBUC and IBNR claims, current portion	1,440,818	2,692,246
Decrease in:		
Deposits held for others		(331,684)
Net cash provided by operating activities	<u><u>\$ 4,443,198</u></u>	<u><u>\$ 2,323,664</u></u>
<b>Noncash investing, capital, and noncapital financing activities:</b>		
Disposal of machinery and equipment	\$ (22,878)	
Accumulated depreciation from disposal of machinery and equipment	22,878	

See accompanying notes to financial statements.



**MARICOPA COUNTY**  
**RISK MANAGEMENT AND EMPLOYEE BENEFITS TRUST FUNDS**  
**Notes to Financial Statements**  
**June 30, 2004**

**NOTE 1 - Summary of Significant Accounting Policies**

The County, in the exercise of the authority granted by Arizona Revised Statutes (A.R.S.) §11-981, has established a trust fund and declares itself self-insured. For financial statement presentation purposes, the Self-insured Trust Fund is reported as Risk Management and Employee Benefits Trust Funds (Funds) and all monies held in these Funds are considered unrestricted. The Funds' financial statements are prepared in conformity with U.S. generally accepted accounting principles applicable to governmental units adopted by the Governmental Accounting Standards Board (GASB). The Maricopa County *Comprehensive Annual Financial Report* for the year ended June 30, 2004, reports the Funds as governmental activities on the government-wide financial statements since they predominantly service the County's governmental funds. A summary of the Funds' more significant accounting policies follows.

**A. Reporting Entity**

The Trust Funds are accounted for as internal service funds of Maricopa County, Arizona, under the direction of an administrator appointed by the County Board of Supervisors. In addition, the Trust Funds are administered by no less than six joint trustees, all of whom shall be citizens of the United States of America and residents of Maricopa County. The County Board of Supervisors also appoints the trustees. However, the ultimate financial accountability for the Funds remains with the County. The County is responsible for the management and operations of the financing of the uninsured risk of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; and for certain health benefits (pharmacy, medical, dental, short-term disability, hospital co-pay reimbursements, medical incentives, and wellness incentives) to eligible employees and their dependents.

**B. Fund Accounting**

The Funds' accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on the Funds' available resources are observed. The principles of fund accounting require that resources be classified for accounting and reporting purposes into funds in accordance with the activities or objectives specified for those resources. Each fund is considered a separate accounting entity, and its operations are accounted for in a separate set of self-balancing accounts that comprises its assets, liabilities, net assets, revenues, and expenses.

The Funds' financial transactions are recorded and reported as internal service funds since their operations are financed and operated in a manner similar to private business enterprises.

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The intent of the County Board of Supervisors is that the costs (expenses, including depreciation) of providing goods or services to other departments within the County on a continuing basis be financed or recovered primarily through user charges.

**C. Basis of Presentation and Accounting**

The financial statements include statements of net assets; statements of revenues, expenses, and changes in fund net assets; and statements of cash flows.

The statements of net assets provide information about the assets, liabilities, and net assets of the Funds at the end of the year. Assets and liabilities are classified as either current or noncurrent. Net assets are classified according to the availability of assets to satisfy the Funds' obligations. Invested in capital assets represents the value of capital assets, net of accumulated depreciation. Unrestricted net assets represent the balance of monies held in the Funds.

The statements of revenues, expenses, and changes in fund net assets provide information about the Funds' financial activities during the year. Revenues and expenses are classified as either operating or nonoperating, and all changes in net assets are reported. Generally, charges for services and insurance premiums are considered to be operating revenues. Other revenues such as investment income are not generated from operations and are considered to be nonoperating revenues. The cost of services, administrative expenses, and depreciation on capital assets are considered to be operating expenses.

The statements of cash flows provide information about the Funds' sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as either operating, noncapital financing, capital financing, or investing.

Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied and determines when revenues and expenses are recognized in the accounts and reported in the financial statements. The financial statements of the Funds are presented on the accrual basis of accounting using the economic resources measurement focus. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place.

The Funds apply only those applicable Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements. The Funds have chosen the option not to follow FASB statements and interpretations issued after November 30, 1989.

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**D. Cash and Cash Equivalents**

The Funds' cash and cash equivalents are held by the County Treasurer in its investment pool, and they are reported at fair value. The Funds' investments in the County Treasurer's investment pool represents proportionate interests in that pool's portfolio; however, the Funds' portions are not identified with specific investments and are not subject to custodial credit risk. Interest earned from investments purchased with such pooled monies is allocated to each of the funds based on their average daily cash balance on a quarterly basis. Interest earned and not received prior to June 30, is recorded as interest receivable.

For purposes of the statements of cash flows, cash and cash equivalents consist of the Funds' share of the pooled portfolio of specific investments purchased by the Maricopa County Treasurer's Office. The County considers only those highly liquid investments with a maturity of 3 months or less when purchased to be cash equivalents.

**E. Machinery and Equipment**

Machinery and equipment are capitalized at cost. Depreciation of machinery and equipment is charged as an expense against operations. These assets are depreciated over their estimated useful lives using the straight-line method. The estimated useful lives of machinery and equipment range from 3 to 10 years.

**F. Employee Compensation Payable**

Employee compensation payable consists of payroll and payroll-related costs incurred but not paid at June 30, and personal time off (PTO) earned by employees based on services already rendered. Employees may accumulate up to 240 hours of PTO, but any PTO hours in excess of the maximum amount that are unused at calendar year-end will be transferred to family medical leave (FML). FML benefits are used by employees for FML-qualifying events and are cumulative but do not vest with employees and, therefore, are not accrued. However, upon retirement, employees of the Funds with accumulated FML in excess of 1,000 hours are entitled to a \$3,000 bonus. The amount of such bonuses is accrued in the liability for employee compensation payable.

**NOTE 2 - Liabilities for Unpaid Claims**

The Funds provide for claims liabilities based on estimates of the ultimate cost of claims, including future claims adjustment expenses, that have been reported but not settled (RBUC), and of claims that have been incurred but not reported (IBNR).

The County is liable for any single claim up to the insurance deductible or self-insurance retention (SIR), whichever is applicable, and the excess over insurance limits. The following

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insurance deductibles, self-insurance retentions, and insurance limits were in effect during fiscal year 2003-04:

<u><b>Policy Type</b></u>	<u><b>Deductible</b></u>	<u><b>SIR</b></u>	<u><b>Limit</b></u>
General and auto liability		\$ 5,000,000	\$ 5,000,000
Excess general and auto liability		primary	25,000,000
Property/inland marine	\$ 100,000		657,255,579
Boiler and machinery	100,000		50,000,000
Earthquake	100,000		100,000,000
Flood zones except A and V	500,000		25,000,000
Flood zone A and V	500,000		10,000,000
Difference in conditions		primary	50,000,000
Employee theft	100,000		10,000,000
Faithful performance of duty	100,000		1,000,000
Theft and robbery	10,000		1,000,000
Computer and wire transfer fraud	100,000		10,000,000
Forgery alteration/property	10,000		1,000,000
Excess workers' compensation		1,000,000	25,000,000
Employer's liability			1,000,000
Medical malpractice		5,000,000	15,000,000
Excess medical malpractice		primary	10,000,000

Settled claims have not exceeded the above commercial insurance coverage limits over the past 3 years.

**Risk Management Trust Fund**

Liabilities for unpaid claims are estimates of the ultimate cost of claims that include the insurance deductible, the SIR, and the excess over insurance limits. The estimates are determined by an independent actuary using the following actuarial methods: reported loss development, paid loss development, Bornhuetter-Ferguson reported loss and paid loss, frequency times severity, case outstanding loss development, expected loss, incremental paid-workers' compensation, paid allocated loss adjustment expense (ALAE) to paid loss development, and tail liability for medical malpractice. Total liabilities are equal to the sum of:

1. Reported but unpaid claims (RBUC), which represent the estimated liability on reported claims established by the Risk Management department and

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2. Incurred but not reported (IBNR) reserves, which include known loss events that are expected to become claims and expected future development on claims already reported. IBNR, therefore, is largely an estimate of loss and claim adjustment expenses associated with future likely claims activity based on historical actual results that establish a reliable pattern.

Accrued actuarial liabilities are based on a discounted 55 percent confidence level assuming a 3.0 percent annual rate of return on investments.

The total liabilities reported at June 30, 2004, categorized by RBUC and IBNR by insurable area follow:

	<b><u>RBUC</u></b>	<b><u>IBNR</u></b>	<b><u>Total Liabilities</u></b>
Auto liability	\$ 210,946	\$ 241,012	\$ 451,958
General liability	15,377,855	6,136,903	21,514,758
Workers' compensation	7,081,299	2,332,196	9,413,495
Medical malpractice	7,553,959	3,100,992	10,654,951
Auto physical damage	131,943		131,943
Property	365,508		365,508
			<u>\$ 42,532,613</u>

The total estimates of unpaid claim liabilities of \$42,532,613 at June 30, 2004, increased by \$1,484,842 from last year's balance of \$41,047,771. The area that significantly increased was general liability.

Changes in the liabilities for unpaid auto, general, workers' compensation, medical malpractice, auto physical damage, and property claims follow:

	<b><u>Balance</u></b>	<b><u>Current-Year</u></b>	<b><u>Claims</u></b>	<b><u>Balance</u></b>
	<b><u>July 1</u></b>	<b><u>Changes in</u></b>	<b><u>Payments</u></b>	<b><u>June 30</u></b>
		<b><u>Estimates</u></b>		
2001-02	\$ 40,569,044	\$ 8,410,852	\$ (7,302,517)	\$ 41,677,379
2002-03	41,677,379	5,907,531	(6,537,139)	41,047,771
2003-04	41,047,771	8,992,628	(7,507,786)	42,532,613

It is estimated that \$15,813,549 of these liabilities will be paid within the next 12 months.

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**Employee Benefits Trust Fund**

The liability for pharmacy, medical, dental, and short-term disability claims as shown below is based on the fiscal year 2003-04 actuarial reports. The hospital co-pay reimbursements program was discontinued effective December 31, 2003. The liability for hospital co-pay reimbursements as shown below is based on historical reimbursements. The liability for medical incentives as shown below is based on the contract with CIGNA HealthCare (CIGNA). Effective January 1, 2004, the HealthSelect medical and related pharmacy program was transferred from the Maricopa Integrated Health System to the Employee Benefits Trust Fund.

Accrued liabilities at June 30, 2004, for each insurable area follow:

Pharmacy	\$ 295,000
Medical	3,568,000
Dental	500,000
Short-term disability	175,000
Hospital co-pay reimbursements	1,150
Medical incentives	600,000
Total	<u>\$ 5,139,150</u>

Changes in the liabilities for unpaid pharmacy, medical, dental, short-term disability, hospital co-pay reimbursements, and medical incentives claims follow:

	<b>Balance</b>	<b>Current-Year</b>		<b>Balance</b>
	<b><u>July 1</u></b>	<b>Claims and</b>		<b><u>June 30</u></b>
		<b><u>Changes in</u></b>	<b><u>Claims</u></b>	
		<b><u>Estimates</u></b>	<b><u>Payments</u></b>	
2001-02	\$ 139,887	\$ 5,842,675	\$ (5,188,478)	\$ 794,084
2002-03	794,084	13,182,511	(11,529,691)	2,446,904
2003-04	2,446,904	24,840,807	(22,148,561)	5,139,150

It is estimated that the June 30, 2004, liabilities balance of \$5,139,150 will be paid within the next 12 months.

**NOTE 3 - Net Assets Deficit**

The County Board of Supervisors elected not to fund the Risk Management Trust Fund's unpaid claims in fiscal years 1995-96 through 1998-99. Consequently, the Risk Management Trust Fund only billed user departments for operating costs and administrative expenses for

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those years. This resulted in a total net assets deficit of \$23,321,519 at June 30, 1999. Starting July 1, 1999, Risk Management began billing user departments for actuarially determined claim estimates that are projected to be paid each fiscal year. As of June 30, 2004, the total net assets deficit has been reduced to \$9,424,450.

**NOTE 4 - Letter of Credit**

On July 1, 2003, the County renewed its workers' compensation insurance with a self-insured retention of \$1,000,000. As a result, the Industrial Commission of Arizona required the County to secure an irrevocable letter of credit in the amount of \$9.1 million with a financial institution to cover unfunded workers' compensation claims. During fiscal year 2003-04, the letter of credit had not been drawn upon. The letter of credit was renewed to July 1, 2005, for \$8.5 million.

**NOTE 5 - Retirement Plan**

**Plan Description**—The Risk Management Fund contributes to a cost-sharing multiple-employer defined benefit pension plan administered by the Arizona State Retirement System (ASRS). Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. The System is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2.

The System issues a comprehensive annual financial report that includes financial statements and required supplementary information. The most recent report may be obtained by writing the ASRS, 3300 North Central Avenue, P.O. Box 33910, Phoenix, AZ 85067-3910 or by calling (602) 240-2000 or (800) 621-3778.

**Funding Policy**—The Arizona State Legislature establishes and may amend active plan members' and the Risk Management Fund's contribution rates. For the year ended June 30, 2004, active plan members and the Risk Management Fund were each required by statute to contribute at the actuarially determined rate of 5.7 percent (5.2 percent retirement and 0.5 percent long-term disability) of the members' annual covered payroll. The Risk Management Fund's contributions to the System for the years ended June 30, 2004, 2003, and 2002 were \$54,687, \$22,894, and \$22,865, respectively, which were equal to the required contributions for the year.